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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In The Matter of	)	
	)	
Implementation of the Pay Telephone Reclassification And Compensation Provisions of the Telecommunications Act of 1996	))))	CC Docket No. 96-128

COMMENTS OF LCI INTERNATIONAL TELECOM CORP.

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July 13, 1998

DC01/AUGUS/58003.1

SUMMARY

The Commission should take the opportunity of this second remand to revise its approach to payphone compensation. The problems with the local coin approach cannot be fixed by adjusting the default rate by a few more pennies, or by providing a more detailed explanation. Rather, the flaws in the approach are much more fundamental. LCI submits that a reasoned response to the Court's concerns can only be achieved by abandoning the local coin approach and replacing it with compensation that is cost-based or with a "caller pays" market solution.

Costs and rates for local coin calls do not converge, as is evidenced by the lack of variation in local coin rates after deregulation. If costs and rates converged, one would expect factors such as regional cost differences or differences in the cost structure of LECs to lead to different local coin rates. However, the evidence suggests that PSPs are increasing their coin rates uniformly.

Similarly, there is no evidentiary support for the proposition that the local coin rate is related in any manner to the rates for access code or subscriber 800 calls. These markets are characterized by different buyers and by different market dynamics. Even the presence of joint and common costs does not suggest a connection between these markets, as many payphone calls share these same costs, but there is no evidence that those rates move in tandem either. Accordingly, the two premises necessary to establish compensation based on the local coin rate are lacking. The Commission has no choice but to abandon its effort to link compensation to that rate.

In the place of the local coin call, the Commission should adopt a cost-based compensation amount. If the Commission properly considers the cost evidence in the record, including the data from LEC PSPs, which provide approximately 75 percent of the payphones in

the nation, it will set a cost-based compensation amount of approximately $.10 to $.15 per call. Alternatively, if the Commission is committed to establishing a market-based rate, it should do so based on the only truly functional market available: a caller pays system.

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LCI International Telecom Corp. ("LCI"),[1] by its attorneys, respectfully submits the following comments in response to the Common Carrier Bureau's *Public Notice* regarding issues presented on remand in the above-captioned docket.[2] LCI submits that the Commission can satisfy the Court's remand only by jettisoning its use of the local coin rate as a "market-based" surrogate for access code and subscriber 800 compensation. In its place, the Commission should establish a reasonable, cost-based compensation amount or, if it believes a "market approach" is needed, should create such a market by adopting the caller pays compensation method.

I. INTRODUCTION

The Commission is in the uncomfortable position of having been reversed twice in the same proceeding for the same core error. In both of its previous compensation decisions, the Commission's error in using the local coin rate as a surrogate for compensation led to grossly

1 LCI is a wholly owned subsidiary of Qwest Communications Corporation.

2 Pleading Cycle Established for Comment on Remand Issues in the Payphone Proceeding, DA 98-1198 (rel. June 19, 1998) (*Public* Notice); *see* MCI *Telecommunications Corporation, et al. v. FCC*, slip op. (D.C. Cir. No. 97-1675 May 15, 1998) (*Payphone II*).

excessive amounts awarded to PSPs. In the initial *Payphone Orders*,[3] the Commission prescribed compensation at an amount equal to a presumed market rate for local calls ($.35). In the *Second Report and Order* (issued after the Court's first remand in this proceeding), the Commission made only slight changes to its compensation plan. Purporting to address the differences in cost between a local coin call, on the one hand, and subscriber 800 and access code calls, on the other, the Commission reduced the compensation amount to $.284.[4] Critically, however, the *Second Report and Order* used the same fundamental premise – that the local coin rate is a surrogate for subscriber 800 and access code compensation.

In both appeals, the Court of Appeals has squarely rejected the logic of the FCC's approach. As the Court in *Payphone II* held, "The Commission never explained why a market-based rate for coinless calls could be derived by subtracting costs from a rate charged for coin calls."[5] This approach is wholly "unreasoned" if the FCC is subtracting one quantity from another, logically independent, quantity.[6] Yet the Commission has not established a connection between the coin rate and the compensation amount to be presubscribed.

The Commission should take the opportunity of this second remand to revise its approach to payphone compensation. The problems with the local coin approach cannot be fixed by adjusting the default rate by a few more pennies, or by providing a more detailed explanation. Rather, the flaws in the approach are much more fundamental. These flaws are illustrated by the

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3 *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Report and Order, 11 FCC Rcd 20,541 (1996), Order on Reconsideration, 11 FCC Rcd 21,333 (1996).

4 *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996* (Second Report and Order) 13 FCC Rcd 1778 ¶ 42 (1997).

5 *Id.* at 11.

6 *Id.*

Court's two principal questions regarding the local coin approach. First, what evidence is there that the local coin rate is itself a competitive rate? That is, what evidence is there that costs and rates converge in the local coin market? Second, why, if the markets for local calls and subscriber 800 or access code calls are different, does it make any sense to tie the compensation rate for one to the "market rate" for the other? LCI submits that the answers to these questions lead to only one conclusion: that the local coin approach must be abandoned.

II. THE LOCAL COIN RATE DOES NOT REFLECT PSP COSTS IN COMPLETING LOCAL CALLS

The *Public Notice* seeks comment on a number of issues relating to the first of the two premises underlying the use of a local coin rate as a basis for compensation. As the Court noted, the Commission's previous orders assumed that the market rate for coin calls reflects the costs of those calls. This assumption is wrong, however.

A. The Only Noticeable Effect of Deregulation Has Been a $1 Billion Increase in Local Coin Rates

The *Public Notice* asks for comment on "competition in the payphone market since the deregulation of payphones and the impact of deregulation on the local coin rate."[7] Unfortunately, deregulation of the local coin rate has increased rates to consumers by $1 billion annually but has not produced competition in the local coin rate.

[7] *Public Notice* at 2.

Given cover by the FCC's declaration of $.35 as the "market rate," all major PSPs quickly raised their coin rates to $.35 per call. This increase is costing consumers over $1 billion annually in additional payphone charges, without any increase in consumer benefits. The uniformity of the coin rate increase suggests that the nature of competition in the payphone industry does not include competition for the rates paid by end users. Rather, the locational monopoly appears to be the norm, not the exception, in end user competition at payphone locations. Because location owners have an incentive to maximize commissions by maximizing end user charges, which is also consistent with the PSP's revenue maximizing strategy, end user rates tend to reflect more the limit of monopoly power than the result of vigorous price competition.

Moreover, there is no evidence that these increased revenues are benefitting consumers in other ways. Although increased revenues sometimes were justified as promoting an increase in deployment of payphones, empirical evidence of this effect is lacking. PSPs have known since September 1996 that coin rates soon would be deregulated, and all major PSPs rapidly increased their coin rates to $.35 after deregulation took effect in October 1997. However, the prospect of these new revenues has not encouraged them to deploy more phones. At least among the largest public PSPs, it appears that they are deploying new payphones (as opposed to increasing their base through acquisition) at approximately the same pace they had been prior to the new compensation rates.[8] This is borne out by LCI's experience paying payphone compensation.

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[8] Peoples Telephone, for example, increased its payphone base by 4,000 between the first quarters of 1997 and 1998, but only 1,400 were the result of new installations (the rest reflected acquisitions of other PSPs). Peoples Telephone, SEC Form 10-Q at 7 (filed 5/15/98). Similarly, Davel Communications, another independent PSP which purchased CCI in 1997 and has recently agreed to acquire Peoples, actually reduced its number of new installations in 1997. Davel Communications, SEC Form 10-K at 4 (1,933 installations in 1997 vs. 2,859 and 2,449 in 1995 and 1996, respectively) (filed 3/31/98). Although it has added 700 new installs in the first quarter of 1998, it is on a pace to add approximately the same number of phones it added in

(continued...)

LCI has not detected an appreciable increase in the number of ownership claims for compensable payphones under the Commission's payphone compensation procedures. If coin rate increases were promoting the deployment of payphones, compensation claims should be increasing as well.

B. There is no Evidence that Costs and Rates Converge in the Local Coin Market

Viewing competition from another way, the experience since deregulation of coin rates does not bear out the proposition that costs and rates converge in the coin call market. As discussed above, PSPs have uniformly increased their local coin rates to $.35 in response to deregulation. If costs and rates converged in the local coin market, however, one would expect significant variances in the local coin rate. These variances should exist, but do not, among PSPs, as well as between phones installed by the same PSP.

Costs – and rates – should vary by PSP. Maintenance and field service costs can be significantly affected by the cost of labor. To the extent that PSPs have higher or lower than average labor costs, they should encounter different overall costs. Similarly, PSPs receive their equipment from different vendors, with different levels of functionality and different prices. Thus, one would expect some PSPs to have a cost advantage over their competitors, which might result in lower overall coin rates. In addition, large LECs appear to be more efficient in their payphone operations, which should give them a price advantage over competing non-LEC PSPs.

If costs and rates converged, one would also expect coin rates to vary by geographic region of the country, because costs vary by region. Payphone access line charges are not

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1995. Davel Communications, SEC Form 10-Q at 16 (filed 5/15/98). Data on LEC PSP installations for 1997 are not available.

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uniform nationwide, and instead can vary significantly from one LEC to another. In addition, installation costs vary by the type of enclosure needed to protect against the elements. As a result, areas with more severe weather conditions and more outdoor locations should result in higher costs than mild regions or regions in which more payphones are shielded by other structures. Factors such as these should result in significant cost variances among payphones located in different regions, even where a single company operates in multiple regions. If the coin rate were reflective of these variances, it too would be higher in some regions and lower in others. Moreover, if substitutability of services were a significant constraint on payphone rates, one would expect coin rates to vary by phone location, because factors such as the proximity of other phones or the availability of alternative calling mechanisms would be different for each location.

All of these cost differences are real, and all must be reflected in the competition among PSPs. Most likely, these cost differences are being reflected in the commissions that they offer to location owners for the right to install a payphone. That is where one sees the variation among providers or locations, not in the local coin rate.

III. <u>THE MARKET FOR LOCAL COIN CALLS IS NOT A SURROGATE FOR ACCESS CODE OR SUBSCRIBER 800 CALLS</u>

Even if the local coin rate were to reflect the costs of such calls, the local coin and coinless markets are substantially different, with different actors and market dynamics for each. These differences preclude the use of the local coin rate as a surrogate for coinless compensation rates.

Most significant among the differences between the markets is the difference in which parties are responsible for payment for the call. In the local coin market, the caller is the buyer of the service. The caller decides whether to place the call, based on factors such as the price for the call, the availability of change, and the convenience of using the phone at that time. Critically, at the time of the purchase decision, the caller knows the rate to be charged and has the ability to determine on a case by case basis whether to place the call (and therefore incur the charge).

In the access code and subscriber 800 markets, on the other hand, the caller only infrequently is the party responsible for paying for the call. For subscriber 800 calls, the buyer is never the caller, but is the called party. For access code calls, the buyer can be the calling card holder (in the case of a card call),[9] the called party (collect calls) or a third party (third number billed calls). As a result, the buyer of an access code or subscriber 800 service is not subject to the same factors as is the caller in the local coin market. Equally importantly, the *caller* in an access code or subscriber 800 context is virtually indifferent to the cost of the call being placed.

Due to these differences, the markets for local coin calls and for subscriber 800 or access code calls are not linked in any way. Changes that can affect the local coin market, such as the availability (or lack thereof) of sufficient coins, will not affect the access code or subscriber 800 markets. Similarly, the factors that an IXC or 800 subscriber would weigh to determine whether to accept a payphone-originated call are not the same as those that would be weighed by the caller in a local coin situation. Therefore, the local coin market will not reflect a market for access code or subscriber 800 calls. It cannot be used as a surrogate for the market price of those calls.

In the *Second Report and Order*, the Commission suggested that the presence of significant joint and common costs in payphone calling justified tying the compensation amount

9 The card holder can be, but is not always, the caller.

to the local coin rate. The presence of joint and common costs, however, does not overcome the fundamental differences among these markets. If the existence of joint and common costs linked the rates of payphone calls, then the local coin rate would be linked to other types of payphone calls, not just subscriber 800 or access code calls. However, there is no evidence that the market rate for a 0+ call, for example, moves in tandem with the market rate for a local coin call. Similarly, if joint and common costs linked payphone calls, a relationship should exist not only between the coin rate and other types of calls, but between any two types of payphone calls. Yet, all evidence indicates these markets operate independent of one another. Accordingly, there is no basis for concluding that the local coin market is a surrogate for any other type of payphone calling market, including coinless calling markets.

IV. THE COMMISSION EITHER SHOULD PRESCRIBE COST-BASED COMPENSATION OR SHOULD CREATE A TRUE MARKET FOR ACCESS CODE OR SUBSCRIBER 800 CALLS

Rather than attempting to support an unsustainable local coin approach, the Commission should revise its course and prescribe compensation on a new basis. The Commission has several rationales it may choose from to arrive at "fair compensation."

A. The Commission Should Adopt a Cost-Based Compensation Amount

The best way to determine fair compensation for these calls is to set the compensation amount based on the cost of the call. Cost-based compensation is consistent with Section 276, is fair, and will promote the widespread deployment of payphones and of payphone services to the public. LCI has always favored a cost-based approach as the most reasonable and fair to all parties. The Commission should adopt that approach now.

It is critical, however, that the cost-based approach reasonably reflect the costs of the payphone industry as a whole, including the LEC PSPs, who appear to be more efficient than other PSPs. In the *Second Report and Order*, the Commission purported to calculate an alternative "bottom-up" cost for payphone calls, but that cost figure was reached only by systematically ignoring LEC cost data and by inflating costs to reflect a hypothetical "low volume" payphone.[10] Neither adjustment appropriately reflects the costs of the payphone industry as a whole. Moreover, even though the Commission conducted this calculation, it (rightly) never relied upon it.[11] Thus, in conducting a cost analysis on remand, the Commission should reject this previous calculation.

Data illustrating the LECs' substantially lower costs has been presented in several forms in the record, including analyses of the Sprint LECs' costs,[12] of Bell Atlantic's cost of operating payphones in Massachusetts,[13] and of SBC's Southwestern Bell Telephone payphone division.[14] This data shows that the cost of originating access code and subscriber 800 calls is in the range of $.10 -.15 per call, far below the compensation that the Commission previously prescribed. Relying on this and any other reliable data submitted in this proceeding, the Commission should set a cost-based compensation amount of no more than $.15 per call.[15]

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10 *Second Report and Order* at 99, 118.

11 *Id.*

12 Sprint 1997 Reply Comments at Exhibit 1.

13 Sprint 1997 Remand Comments at 8-10.

14 AT&T Petition for Reconsideration at Robinson Aff., Attachment I.

15 As a third alternative, LCI does not object to using the AT&T/APCC negotiated access code compensation amount as evidence of the market rate for access code calls. Provided that this amount is adjusted to reflect the different market characteristics of subscriber 800 calls, the AT&T/APCC rate can be used in the calculation of a blended rate for both subscriber 800 and access code calls. *See* AT&T 1997 Remand Reply Comments at 12-14.

B. In the Alternative, A System Where the Caller Deposits Coins to Make a Call is the Only True Market-Based Alternative

If the Commission is committed to creating a market-based compensation rate, rather than setting cost-based compensation, it should do so on the basis of a market that can actually work, not on a surrogate market that bears no relationship to coinless calling. Specifically, if the Commission wishes to establish a market approach to compensation it should adopt the "caller pays" approach suggested by many commenters in this proceeding. The caller pays approach aligns the seller (the PSP) and the buyer (the caller) in a direct transaction, which sends the proper price signals for a functioning market.

Supporters of caller pays have shown that this approach is consistent with statutory principles, is feasible, and is the least costly method of administering payphone compensation. It is within the Commission's discretion to adopt or reject caller pays as a fair compensation method. If the FCC is committed to a market approach to compensation, caller pays is the only appropriate option. At a minimum, the FCC cannot adopt a different market-based approach without explaining why that approach reflects the market for coinless calls better than caller pays would.

CONCLUSION

For the foregoing reasons, the Commission should abandon its attempt to set compensation based in any manner on the local coin rate charged by PSPs. The local coin approach is not a surrogate for the costs of coinless calls because there is no evidence that costs and rates converge in the local coin market and because the local coin market operates independently of the access code and subscriber 800 calling markets. In its place, LCI suggests compensation be determined using one of two alternatives. First, the Commission could set cost-based compensation using reliable data representative of the payphone industry as a whole. This compensation would not exceed $.15 per call. Second, if the Commission is determined to establish market-based compensation, it should adopt the caller pays approach, because that is the only approach that establishes a true market for access code and subscriber 800 calling

Respectfully submitted,

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July 13, 1998